

STATE CORPORATION COMMISSION

AT RICHMOND, JUNE 27, 2008

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APPLICATION OF

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VIRGINIA ELECTRIC AND POWER COMPANY

CASE NO. PUE-2008-00039

To revise its fuel factor pursuant to
Va. Code § 56-249.6

ORDER ESTABLISHING FUEL FACTOR

On May 6, 2008, Virginia Electric and Power Company ("Virginia Power," "Company," or "DVP") filed with the State Corporation Commission ("Commission") its application, written testimony, and exhibits requesting to increase its current fuel factor from 2.232¢ per kWh to 4.245¢ per kWh, effective for usage on and after July 1, 2008, based on a projected increase in fuel expense for the 2008-2009 fuel factor period of approximately \$1.1 billion above the Company's 2007-2008 fuel cost recovery level and the proposed recovery of \$231 million of the fuel expenses deferred in the 2007-2008 fuel year.

The fuel factor includes both a current period factor and a prior period factor. The filed fuel factor of 4.245¢ per kWh included: (1) a current period factor of 3.893¢ per kWh, which is designed to recover the Company's total estimated Virginia jurisdictional fuel expenses of approximately \$2.6 billion for the period July 1, 2008 through June 30, 2009; and (2) a prior period factor of 0.352¢ per kWh, which is designed to recover approximately \$231 million of the June 30, 2008 deferred fuel balance over that same twelve-month period.¹ This amount represents that part of the Company's estimated June 30, 2008 deferred fuel balance that would be recovered by increasing the total rates of the residential class of customers by 4% over the level of such total rates in existence on June 30, 2008.

¹ The Company's application estimates the projected June 30, 2008 deferred fuel balance to be \$697 million.

In addition to its filed fuel factor of 4.245¢ per kWh, Virginia Power concurrently filed a Proposed Rule that, if adopted, would change the impact of its filed fuel factor. Specifically, adoption of the Proposed Rule would result in implementation of a current period factor of 3.893¢ per kWh and defer recovery of the entire estimated \$697 million June 30, 2008 deferred fuel balance to the three succeeding fuel periods of 2009-2010, 2010-2011, and 2011-2012, without recovery of any portion of such balance in the 2008-2009 period. Fuel Charge Rider B (0.338¢ per kWh) attached to the Proposed Rule would provide for recovery of the entire estimated \$697 million deferred fuel balance on a straight-line basis over such three succeeding fuel periods.

On May 9, 2008, the Commission issued an Order Establishing 2008-2009 Fuel Factor Proceeding ("Scheduling Order") that, among other things: (1) established a procedural schedule for this matter; (2) required the Company to provide public notice of its application and Proposed Rule; (3) scheduled a public hearing for June 24, 2008; and (4) permitted the submission of legal memoranda addressing the legal permissibility of the Proposed Rule and whether the Commission can approve the Proposed Rule as part of this proceeding.

The following parties filed notices of participation in this case on or before June 12, 2008: Virginia Committee for Fair Utility Rates ("Committee");² Virginia Retail Merchant's Association ("VRMA"); MeadWestvaco Corp. ("MeadWestvaco"); Department of the Navy on behalf of all Federal Executive Agencies ("FEA"); Apartment and Office Building Association of Metropolitan Washington ("AOBA"); and the Office of the Attorney General's Division of Consumer Counsel ("Consumer Counsel").

² The members of the Committee are: Abbott Laboratories; Air Liquide Large Industries US L.P.; Anheuser-Busch, Inc.; Dynaric, Inc.; E.I. du Pont de Nemours & Co., Inc.; General Motors Corporation; Honeywell; International Paper; Northrop Grumman Newport News; Praxair, Inc.; Qimonda North America; Sentara Norfolk General Hospital; and United States Gypsum Company.

The following filed legal memoranda as permitted by the Scheduling Order: Virginia Power; Consumer Counsel; and Staff. The following filed written testimony as permitted by the Scheduling Order: Virginia Power; Committee and VRMA, jointly; FEA; Consumer Counsel; and Staff. In addition, the Commission received over forty (40) written or electronic comments on or before June 19, 2008.

The evidentiary hearing was held on June 24, 2008. Virginia Power's proof of service and notice, as required by the Scheduling Order, was accepted into the record. The following were represented by counsel at the hearing: Virginia Power; Committee; VRMA; FEA; AOBA; Consumer Counsel; and Staff. In addition, six public witnesses testified at the hearing.

Finally, the following parties jointly submitted a Proposed Stipulation and Recommendation ("Stipulation") at the hearing: Virginia Power; Committee; VRMA; MeadWestvaco; AOBA; and Consumer Counsel. The parties to the Stipulation, among other things, agreed that:³

- (i) Virginia Power "is entitled to place in effect a tariff of 3.893 cents per kilowatt-hour ('2008-2009 fuel tariff') pursuant to the provisions of Va. Code § 56-249.6.C for the period from July 1, 2008 through June 30, 2009 ('2008-2009 fuel period');"
- (ii) "[P]ursuant to the provisions of Va. Code § 56-249.6.C, \$231 million of the [approximately \$697 million increased deferral ('Increased Deferral')] shall be recovered in the 2008-2009 fuel period as a part of the 2008-2009 fuel tariff, with the balance of such Increased Deferral to be recovered in subsequent fuel periods as provided in Va. Code 56-249.6.C;"
- (iii) "[T]he reduction in the fuel factor from 4.245 cents as proposed in the Company's application in this case to 3.893 cents per kWh is estimated to result in an under recovery of \$231 million during the 2008-2009 fuel period ('\$231 Million Under Recovery');" and

³ Exhs. 8 and 9 (Stipulation). Exhibit 8 is the Stipulation signed by: Virginia Power; Committee; VRMA; AOBA; and Consumer Counsel. Exhibit 9 was reserved at the hearing to receive MeadWestvaco's signature on the Stipulation, which was provided to the Commission's Bailiff prior to the conclusion of the hearing.

- (iv) "[T]he Company will not propose to recover a return on or interest or any other form of carrying costs for purposes of the Company's 2008-2009 fuel tariff, future fuel tariffs, or calculation of the Company's revenue requirement pursuant to Va. Code § 56-585.1.A or any other rate proceeding on (1) the \$231 Million Under Recovery or (2) the Increased Deferral, provided, however, that Dominion Virginia Power and the Participants also agree that the total amount on which the Company will not propose to recover interest or any other form of carrying costs in any such proceedings is limited to \$697 million."

In addition, Virginia Power withdraws its request for the Proposed Rule if the Stipulation is approved. The Staff and FEA do not oppose the Stipulation.

NOW THE COMMISSION, upon consideration of this matter, is of the opinion and finds as follows. The Commission approves the Stipulation. The Company's current fuel factor of 2.232¢ per kWh shall be increased to 3.893¢ per kWh, effective for usage on and after July 1, 2008.-

Pursuant to Va. Code § 56-249.6, Virginia Power is statutorily entitled to recover its prudently incurred fuel costs. Indeed, in describing this statutory provision almost twenty years ago, the Commission explained that the fuel factor permits *dollar for dollar* recovery of prudently incurred fuel costs.⁴

Furthermore, and as also explained in prior fuel cases, approval of a fuel factor herein does not represent ultimate approval of the Company's actual fuel expenses. The instant Order Establishing Fuel Factor is based upon the Stipulation, which we have found appropriate for purposes of this case. An audit and investigation of the Company's actual booked fuel expenses,

⁴ *Commonwealth of Virginia, ex rel. State Corp. Comm'n, Ex Parte: In the matter of establishing Commission policy regarding rate treatment of purchased power capacity charges by electric utilities and cooperatives*, Case No. PUE-1988-00052, 1988 S.C.C. Ann. Rept. 346, 347 (Nov. 10, 1988) (describing the "fuel factor" as "a statutory adjustment mechanism through which all prudently incurred energy costs are recovered, *dollar for dollar*" (emphasis added)). See also *Application of Kentucky Utils. Co., t/a Old Dominion Power Co., To revise its fuel factor pursuant to Virginia Code § 56-249.6*, Case No. PUE-1994-00043, 1995 S.C.C. Ann. Rept. 309, 310 (Jan. 6, 1995) ("*Kentucky Utils.*") (explaining that the "fuel factor mechanism . . . gives the Company *dollar for dollar* recovery for allowable fuel expenses" (emphasis added)).

among other things, is conducted by the Staff after the close of the fuel year. The Commission subsequently determines what are, in fact, reasonable, prudent and, therefore, allowable fuel expenses and credits, as well as the Company's recovery position as of the end of the audit period. For example, the Commission has previously described this review as follows:

Should the Commission find in its Final Audit Order (1) that any component of the Company's actual fuel expenses or credits has been inappropriately included or excluded, or (2) that the Company has failed to make every reasonable effort to minimize fuel cost or has made decisions resulting in unreasonable fuel cost, the Company's recovery position will be adjusted. This adjustment will be reflected in the recovery position of the Company's next fuel factor. We reiterate that no finding in this order is final, as this matter is continued generally, pending Staff's audit of actual fuel expenses.⁵

Likewise, while we find that the fuel factor approved herein shall be implemented for usage on and after July 1, 2008, no finding in this Order Establishing Fuel Factor is final, as this matter is continued generally, pending audit and investigation of the Company's actual fuel expenses.

The fuel factor approved herein is comprised of (1) a current period factor of 3.541¢ per kWh, and (2) a prior period factor (*i.e.*, correction factor) of 0.352¢ per kWh. As discussed by Staff witness Lamm, we find that the correction factor of 0.352¢ per kWh "complies with the 2007 fuel year deferral recovery limitations imposed by § 56-249.6 C of the Code of Virginia, which limits the rate increase for such recovery to 4 percent of the existing total Residential rates."⁶

Next, and as recommended by Staff witness Pate, we find that Virginia Power shall "calculate and adjust its deferred fuel balance to reflect the fuel related facilities payments that

⁵ *Kentucky Utils.*, 1995 S.C.C. Ann. Rept. at 311.

⁶ Exh. 25 (Lamm direct) at 5.

should offset the cost of fuel used by DVP affiliates or departments effective July 1, 2007," as directed below.⁷

Finally, Consumer Counsel witness Norwood, among other things, explains that:

(i) Virginia Power "purchases approximately 20% of its total system fuel requirements from unregulated affiliates;" (ii) the Company's "forecasted off-system sales (OSS) margins are approximately 1% of the level achieved by Appalachian Power Company over the last several years, even though it appears that DVP will have excess low-cost coal-fired generation available for sale during the forecast period;" and (iii) the Company "purchases 100% of its oil and natural gas requirements on a spot market basis."⁸ FEA witness Brubaker also recommends that, "[g]oing forward," VEPCO take specific actions regarding risk management and hedging activities for heavy oil, natural gas, and wholesale electricity purchases.⁹ In this regard, we herein direct as follows:

- (1) As part of the fuel audits referenced above, the Staff shall audit and investigate whether, as testified to by the Company, all system fuel purchases from the Company's affiliates were executed at "the lower of cost or market price standard,"¹⁰
- (2) On or before October 1, 2008, the Company shall file a report with the Commission's Division of Energy Regulation that provides a detailed explanation, with supporting workpapers, of (a) the Company's level of annual off-system sales, and (b) any reasonable methods by which to increase the same; and
- (3) On or before October 1, 2008, the Company shall file a report with the Commission's Division of Economics and Finance that provides a detailed explanation, with supporting workpapers, of (a) the Company's current risk

⁷ Exh. 23 (Pate direct) at 8.

⁸ Exh. 22 (Norwood direct) at 6-7.

⁹ Exh. 14 (Brubaker direct) at 3.

¹⁰ Exh. 15 (Workman rebuttal) at 4-5. The prefiled direct and rebuttal testimonies of Mr. Workman were received into the record collectively as Exh. 15.

management program for its procurement of oil, natural gas, and wholesale electricity, and (b) the analyses undertaken in adopting and implementing such plan and in rejecting alternatives.

Accordingly, IT IS HEREBY ORDERED THAT:

(1) The Company's current fuel factor of 2.232¢ per kWh shall be increased to 3.893¢ per kWh, effective for usage on and after July 1, 2008.

(2) The Proposed Stipulation and Recommendation is approved.

(3) Virginia Power shall comply with the Proposed Stipulation and Recommendation approved herein.

(4) Within 60 days from the date of this Order Establishing Fuel Factor, the Company shall file with the Commission's Division of Public Utility Accounting a schedule, with supporting documentation, showing the total adjustment to its deferred fuel balance reflecting the fuel related facilities payments that offset the cost of fuel used by Virginia Power's affiliates or departments since July 1, 2007.

(5) As part of its fuel audits, the Staff shall audit and investigate whether all system fuel purchases from the Company's affiliates were executed at the lower of cost or market price standard.

(6) On or before October 1, 2008, the Company shall file a report with the Commission's Division of Energy Regulation that provides a detailed explanation, with supporting workpapers, of (a) the Company's level of annual off-system sales, and (b) any reasonable methods by which to increase the same.

(7) On or before October 1, 2008, the Company shall file a report with the Commission's Division of Economics and Finance that provides a detailed explanation, with supporting workpapers, of (a) the Company's current risk management program for its procurement of oil,

natural gas, and wholesale electricity, and (b) the analyses undertaken in adopting and implementing such plan and in rejecting alternatives.

(8) The Company's proposed Fuel Charge Rider A, admitted into the record as Exh. 18 during the hearing, is accepted for filing and shall become effective for service rendered on and after July 1, 2008.

(9) This case is continued generally.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to all persons on the official Service List in this matter. The Service List is available from the Clerk of the State Corporation Commission, c/o Document Control Center, 1300 East Main Street, First Floor, Tyler Building, Richmond, Virginia 23219.

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